UPREME COURT, U. S.

No. 127

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IN THE

Supreme Court of the United States

October Term, 1967

READING COMPANY, *Petitioner*

v.

FRANCIS SHUNK BROWN, 3RD, *Trustee of the Estate of* I. J. KNIGHT REALTY CORP., *Bankrupt, Respondent*

and

UNITED STATES OF AMERICA, *Respondent*

On Writ of Certiorari to the United States Court of Appeals for the Third Circuit

BRIEF FOR PETITIONER

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On Writ of Certiorari to the United States Court of Appeals for the Third Circuit

BRIEF FOR PETITIONER

This is a petition to review a judgment of the Court below affirming a judgment of the District Court, which had affirmed an order of the referee in bankruptcy expunging petitioner's claim from the record.

OPINIONS BELOW

The majority and the dissenting opinions in the Circuit Court of Appeals are reported at 370 F. 2d 624 (3 Cir. 1967) Record App., pp. 50-61. The opinion of the District Court is reported at 242 F. Supp. 337 (E. D. Pa. 1965) Record App., pp. 36-49.

JURISDICTION

The judgment of the Court of Appeals affirming the judgment of the District Court was entered on January 6, 1967. Rehearing was denied on February 13, 1967. The petition for a writ of certiorari was filed on May 4, 1967, and was granted on October 16, 1967. Jurisdiction of the Supreme Court to review this order is conferred by 28 U.S.C. §1254(1).

QUESTIONS PRESENTED

1. Whether tort claims resulting from the negligence of a receiver in operating the business of a debtor, pursuant to court authorization in a Chapter XI Bankruptcy proceeding, are entitled to priority as "costs and expenses of administration".

2. Whether denial of such priority, with the resulting immunity of debtor's estate from liability for the receiver's negligence, would deprive petitioner and the other tort claimants of their property without due process of law in violation of the Fifth Amendment to the United States Constitution.

CONSTITUTIONAL PROVISIONS AND STATUTES INVOLVED

The pertinent constitutional provision is the Due Process clause of the Fifth Amendment to the United States Constitution, U.S.C. Const. Amend. V.

The pertinent statutory provisions involved in this case are: Sections 2, 62(a)(1), 63(a)(7) and 64(a)(1) of the Bankruptcy Act, 11 U.S.C. §§11, 102(a)(1), 103(a)(7) and 104(a)(1); and 28 U.S.C. §959(a) and (b).

The texts of the constitutional provision and the foregoing statutes are set out in the Brief App., pp. 23-27, infra.

STATEMENT OF THE CASE

On November 16, 1962, I. J. Knight Realty Corp. (Knight Realty) filed a petition for an arrangement under Chapter XI of the Bankruptcy Act. On the same day the District Court appointed Francis Shunk Brown, 3rd, as receiver and authorized him to operate the business of Knight Realty.

The only significant asset of Knight Realty was an eight-story industrial structure known as the Fretz Building located at Tenth and Diamond Streets, Philadelphia, Pennsylvania. The business of Knight Realty consisted of leasing space in the Fretz Building and operating the building for the benefit of its tenants.

On January 1, 1963, the Fretz Building was totally destroyed by a fire of unusual intensity. The conflagration spread to adjoining premises, damaging or destroying real and personal property of Reading Company (Reading) and others. On April 3, 1963, Reading filed a claim for $559,730.83, which it styled as a claim for "administrative expenses due to the negligence of the Receiver" in operating the business of Knight Realty. In essence, Reading's claim alleged that the receiver was negligent in permitting the fire to start and "spread beyond its normal confines." [1]

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[1] It was stipulated that "All of the well pleaded allegations of fact in the Reading Company's Statement of Claim are to be deemed true for the purposes of the Trustee's Motion to Dismiss or Expunge the Claim of the Reading Co." (Case stated, Record App., pp. 21-22). Briefly, petitioner there alleged that the receiver and its agent, the chief engineer of the Fretz Building, were negligent in that they did not keep the building sufficiently heated to enable the sprinkler system to remain operative; that as a result the sprinkler system was frozen solid on December 31, 1962 and January 1, 1963, and the system was turned off for repairs and left on January 1, 1963, in an unrepaired and inoperative condition; that, when engaged in turning off the sprinkler system, the chief engineer made an improper electrical connection which ultimately caused the fire; and that the fire spread beyond its normal confines because the sprinkler system was inoperative and, in its absence, no fire watch was maintained. (Proof of Claim, Record App., pp. 4-16.)

Thereafter, other fire loss claimants filed 146 additional claims for administrative expenses based on the alleged negligence of the receiver. The total of all such claims including Reading's exceeds $3,500,000. The referee has ruled that this will be a "test case" which will determine if the fire loss claimants are entitled to prove their losses as expenses of administration. Record App., pp. 18-20.

On May 14, 1963, Knight Realty was adjudicated a bankrupt pursuant to a voluntary consent to adjudication filed on its behalf, and respondent Francis Shunk Brown, 3rd, was subsequently elected trustee in bankruptcy.

Other claims filed in the matter consist of: federal tax claims of $244,953.91; other tax claims of $70,823.19; secured claims of $230,619.04; unsecured claims of $76,-905.47; and wages, $860.00.

It was estimated that the trustee would have on hand between $630,000 and about $845,000, depending on the outcome of certain litigation against fire insurance companies then pending.

The trustee petitioned the court to expunge Reading's claim on the ground that it was not an administration expense within the meaning of the Bankruptcy Act. The referee granted the motion and expunged Reading's claim, not only as an expense of administration but also as an unsecured general claim. The District Court affirmed the order of the referee. The Court of Appeals affirmed the decision of the District Court, with three judges dissenting.

The United States of America has been named as a respondent because it opposed petitioner below. The United States has filed a federal tax claim against the estate which would not be paid if petitioner's position is sustained, because of the insufficiency of the estate.

SUMMARY OF ARGUMENT

Petitioner contends that the tort claims arising out of the negligence of the receiver in operating the debtor's business pursuant to court authorization are entitled to priority of payment as "costs and expenses of administration" for the following reasons:

1. Costs and expenses of administration in bankruptcy proceedings and their priorities of payment are governed by Section 64(a)(1) of the Bankruptcy Act which gives them a first priority. Since Congress did not indicate what it meant by the phrase "costs and expenses of administration," it is reasonable to assume that it intended the words to have the usual and ordinary meaning which they have in normal business practice and which they have acquired in the equity law of insolvent and distressed debtor's estates, and the courts have generally so construed it.

2. Claims arising out of torts committed by receivers, whether in equity receivership or bankruptcy, have always been given priority status as costs and expenses of administration, and all text writers agree that this is the law.

3. Claims arising out of the receiver's torts in operating the debtor's business are as much an expense of operation as are taxes, wages and materials and supplies, and are entitled to equal priority as costs and expenses of administration. All courts, including this Court, have so treated them.

4. The construction of the Bankruptcy Act adopted by the court below immunizing receivership funds from liability for the torts of the receiver operating the business, in competition with others, for the benefit of pre-bankruptcy creditors (a) nullifies the Act of Congress making receivers liable for their acts while carrying on a bankrupt's business (28 U.S.C. §959), and (b) is so arbitrary and capricious as to violate the due process clause of the Fifth Amendment.

ARGUMENT

I. THE TORT CLAIMS ARE CLEARLY ENTITLED TO PRIORITY AS "COSTS AND EXPENSES OF ADMINISTRATION" UNDER SECTION 64(a)(1) OF THE BANKRUPTCY ACT.

A. *Section 64(a)(1) of the Bankruptcy Act Gives First Priority to Costs And Expenses of Administration."*

The receiver was appointed pursuant to a petition filed under Chapter XI of the Bankruptcy Act, 11 U.S.C. §§701-799, and the debtor was later adjudicated a bankrupt.[2] Section 64 of the Bankruptcy Act, 11 U.S.C. §104, sets forth the priority of payment of debts, with the relevant portion of the section reading as follows:

> "Section 64. Debts which have priority.
>
> (a) The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment, shall be (1) the costs and expenses of administration, including the actual and necessary costs and expenses of preserving the estate subsequent to filing the petition; . . ."[3]

Section 62(a)(1), 11 U.S.C. §102(a)(1), is the source of authorization to the bankruptcy court for the payment of administration expenses. It provides for the reporting under oath, and examination and approval or disapproval

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[2] Section 302 of Chapter XI (11 U.S.C. §702) provides that the provisions for ordinary bankruptcy (Chapters I-VII) ". . . shall, insofar as they are not inconsistent with or in conflict with this chapter, apply in proceedings under this chapter."

[3] The full text of Section 64 is contained in the Brief App., pp. 25-26 infra.

by the court of "the actual and necessary costs and expenses incurred by officers, other than referees, in the administration of estates. . . .[4]

Neither Section 62 nor Section 64 defines the meaning of the term "costs and expenses of administration."

B. *Since Congress Did Not Define "Costs and Expenses of Administration," It Must Have Intended the Term to Include Normal Business Practice and what Had Become Established as Proper Costs and Expenses under the Practice in Equity.*

Congress did not undertake to define what it meant by the term "costs and expenses of administration" as used in either Section 62(a)(1) or Section 64(a)(1) of the Bankruptcy Act; and a careful reading of the Bankruptcy Act reveals no discussion whatever by Congress of what it meant by the term. 3 Collier on Bankruptcy, §62.02(1) (14 ed. 1964). From this it can be assumed that Congress had in mind normal business practice and also what have been established as costs and expenses under the practice in equity.

The Bankruptcy Act specifically provides in Section 2 that the bankruptcy court is a court of equity. Bankruptcy Act, Section 2, 11, U.S.C. §11. Brief App., p. 23 infra.

As was said by this Court, in the case of *Securities & Exchange Commission v. U. S. Realty Co.*, 310 U.S. 434 (1940), in discussing Chapters X and XI of the Bankruptcy Act, at page 457:

> "Good sense and legal tradition alike enjoin that an enactment of Congress dealing with the bankruptcy should be read in harmony with the existing system of equity jurisprudence of which it is a part."

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[4] Section 62(a)(1), is set forth in the Brief App., p. 24, infra.

The principle was reiterated in the recent case of *Bank of Marin v. England*, 385 U.S. 99 (1967), where this Court said at p. 103:

> "There is an overriding consideration that equitable principles govern the exercise of bankruptcy jurisdiction."

See also 3 Collier on Bankruptcy, §62.03 et seq (14th ed. 1964).[5]

As will be seen later, all of the equity cases, without exception, give claims arising out of the torts of a receiver priority status as costs and expenses of administration.

Congress provided in 28 U.S.C. §959(b) (Brief App., p. 27 infra) that a receiver who operates the business of a debtor shall do so subject to the same requirements of law and in the same manner as if he were the debtor.[6] This, coupled with equitable considerations, necessarily requires that the receiver's operation of a business under a Chapter XI proceeding be subject to such risks and liabilities as are normally entailed in a business operation, including tort claims. 3 Collier on Bankruptcy (14th ed. 1964) §62.15, pp. 1539-40.[7]

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[5] In 3 Collier on Bankruptcy §62.03, p. 1414 (14th ed. 1964), it is stated with respect to Section 62.

> "As a matter of substantive law the court is instructed to order approved costs and expenses to be paid or allowed *out of the estate in which they were incurred.* This provision codifies what equity would seem to require unless the administration of estates be unconditionally treated as a governmental function exercised by salaried officers." (Italics in original.)

[6] This Court may judicially note that operations under Chapter XI may extend over lengthy periods of time during which a receiver or debtor-in-possession is in competition with others who assume tort liability as a normal business risk.

[7] In 3 Collier on Bankruptcy, 14th Ed., §62.15 (pp. 1537-40) it is stated:

> "Section 2a (5) empowers the court to authorize the business of bankrupts to be conducted for a limited period by a marshall, receiver or trustee. Such continued operation of a

C. *The Few Bankruptcy Cases which Have Discussed the Problem Have Treated Tort Claims against Receivers and Trustees as Expenses of Administration.*

Petitioner has found only one case which involves the precise issue of whether a tort claim against a trustee in bankruptcy is an expense of administration entitled to priority under the provisions of the Bankruptcy Act. That case is *In re Progress Lektro Shave Corporation*, 35 F. Supp. 915 (D. Conn. 1940). There the trustee sold articles protected by a patent belonging to the claimant after notice by the patentee of his rights. The court held that the sale was an infringement of the claimant's rights and ordered

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business is in substance a means of preservation, namely as a going concern, sometimes with a view to rehabilitation and bridging a critical period, more frequently in preparation for a more advantageous sale of the assets. Expenditures incurred by continued operation of a bankrupt's business will, therefore, on principle follow the rules outlined in §62.14 as to expenditure in connection with preservation. *The difference, if any, lies in the greater variety of types of expenses, rather than in their legal treatment, provided always that the business is conducted under special and express authority of the court.* . . .

"As compared to where property is merely to be protected from deterioration or loss, employment of assistance in a going concern is necessarily of a wider scope. Power to hire help within the reasonable needs of a business is implied in the authority to conduct a business. Salaries and wages are among the recognized costs of continuing business, as are expenses incurred for rent and for necessary material and merchandise. . . .

"The officer's tax duties and liabilities . . . gain particular importance during operation of a business. . .

"Among other expenses incident to conducting a business and therefore allowable as administrative expenditure may be royalties for a patented process of manufacture, fees of detectives hired to discover persons involved in theft of assets, *payments on claims for personal injuries inflicted in the operation of a business*, rent, insurance, commissions, cost of raw material or merchandise purchased for manufacturing or resale *and any other expense ordinarily attendant upon active participation in commercial or industrial life.*" (Emphasis added.)

that the "claim be allowed in the amount of $1000 with the priority pertaining to an expense of administration." The court said at page 916:

> "Holding, as I do, that upon the facts as found by the Referee the sale by the trustee was in violation of the claimant's rights, it follows that the claim must be allowed as an expense of administration."

A case of greater authority, although the precise issue of priorities was not directly involved, is *Vass v. Conron Bros. Co.*, 59 F. 2d 969 (2d Cir. 1932). There a trustee in bankruptcy who was operating a cold storage plant permitted the refrigeration to fail so that perishable goods belonging to a lessee were spoiled. The lessee sued the trustee in the state court alleging breach of contract and negligence and the trustee obtained an order enjoining the prosecution of the suit. The Court of Appeals affirmed the granting of the injunction in an opinion by Judge Learned Hand, in which that respected judge held that the damages sustained by the lessee were payable as expenses of administration. He stated at page 971:

> ". . . the liquidation of the lessee's resulting damages was as much a part of the usual administration in bankruptcy, as that of the pay of accountants, custodians or other assistants, employed by the trustee."

It has been suggested (we believe erroneously) that this is dictum. Dictum or not, it is an unqualified expression of opinion by this eminent jurist and is entitled to great weight, particularly in view of the dearth of bankruptcy decisions on this point.

There are no cases contrary to the above two cases.[8]

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[8] As pointed out in the dissenting opinion in the court below (370 F. 2d at p. 630, Record App., p. 60), none of the cases cited by the court in support of its refusal to apply the equity rule involved tort claims.

The paucity of cases on the subject is probably due to the fact that damages or personal injuries caused by the negligence of receivers and trustees are normally covered by liability insurance, and the bankrupt estate would therefore not be directly involved.[9]

The recent case of *In re Hudson & Manhattan Railroad Company*, 178 F. Supp. 103 (S.D.N.Y. 1959) affirmed sub nom *Angus v. Stichman*, 273 F. 2d 707 (2 Cir. 1960), is particularly significant. There priority status in the administration of the estate of the debtor, which was in reorganization under Chapter X of the Bankruptcy Act,[10] was sought for 91 employee and non-employee claims arising prior to the appointment of the receiver. The court described

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[9] In its brief in opposition to the petition for certiorari, respondent trustee states (p. 5):

> "Surely at other times and places torts have been committed by bankrupts to or against property contiguous to theirs, or to persons in the vicinity of or on a bankrupt's property, or by vehicles belonging to bankrupts. No case, however, has been found in which a contention similar to that of the present petitioner has been made. The reason for the absence of cases may be that the liability insurance proceeds were adequate to pay losses incurred. In the present situation the fire was of woefully unique proportions, and no reasonably foreseeable insurance coverage could possibly have been adequate or even carried."

It is submitted that the existence of insurance coverage is not a proper criterion for determining the priority status of a tort claim.

[10] Debtor did not qualify as a railroad company entitled to reorganization under Section 77 of the Bankruptcy Act. This was so ruled in the above case. It is true that under Chapter X, it is specifically provided (11 U.S.C. §515) that the receiver shall operate the property as a receiver in equity and therefore Section 64(a)(1) may not be applicable. Nevertheless it has been recognized that Chapter X receiverships are fundamentally similar to, if not indistinguishable from, Chapter XI proceedings where a receiver or debtor-in-possession has been authorized by the court to continue a business. See Hirsch & Krause, *Bankruptcy, Arrangements under Chapter XI*, p. 81 fnl. The distinction between Chapters X and XI has been thin, if not illusory, since this Court's decision in *S.E.C. v. U.S. Realty and Improvement Co., supra*, p. 7.

the debtor's business as having "two interrelated aspects: the ownership and operation of an interurban electric railway and the ownership and operation of two large office buildings and other real estate in downtown Manhattan in the City of New York" (p. 104). In denying priority status to all of the claims, the court stated (p. 104):

> "It is well established that all tort claims against a Debtor which has gone into receivership are to be denied priority *if the claims ante-dated the receivership.*" (Emphasis added.)

It is obvious from the above quotation that the court would have permitted priority status if the tort claims had arisen during the receivership, as is the case here.

D. *All of the Text Writers State Categorically that Tort Claims against Receivers Generally Are Allowable as Expenses of Administration Without Making any Distinction between Receivers in Equity or Bankruptcy.*

The following are typical quotes from the texts:

45 Am. Jur., Receivers, §255 (1943):

> "It is a general rule that claims arising out of authorized transactions with the receiver or out of the conduct of the receivership, including those based on the proper costs and expenses of the receivership, and on the torts of the receiver or his agent in the administration of the receivership, are the ranking claims against the estate in receivership."

45 Am. Jur., Receivers, §349 (1943):

> "A receiver operating a railroad or other property or business generally is liable . . . for his torts or negligence in such operation or for the torts or negligence of his agents and employees in such operation. . . . Such liability is deemed part of the operating expenses of the receivership."

2 Clark, Receivers, §396(h) (3rd ed. 1959):

> "When a receiver is appointed to operate a business he may be guilty of tort. For instance a receiver is frequently appointed in foreclosure proceedings to manage and conserve the property which may consist of buildings or plants which must be kept in operation. In operating such buildings, the receiver or his subordinates may be guilty of acts or failure to act or negligence which will result in a tort. . . .
>
> "Damages resulting from the operation of the plant or in business being incidental to the management generally become part of the expense of administration by the court."

2 Clark, Receivers, §640.9 (3rd ed. 1959):

> "Costs and expenses may include torts arising out of operation of property.
>
> "In the operation of a railroad or other property, torts may be committed directly by the receiver or indirectly by his agents. Under our American system of jurisprudence a receiver when properly obeying the orders of court is liable officially and not personally.
>
> "Damages for injuries to persons or property during the receivership and resulting from the operation thereof by the receiver are part of the operating expenses of the receivership and payable first out of income and second out of the corpus."

75 C. J. S., Receivers, §293(h), page 943 (1952):

> "Damages for injuries to persons or property during a receivership, caused by the torts of the receiver's agents or employees, are classed as part of the operating expenses and are entitled to the preference accorded to claims of that character."

3 Collier on Bankruptcy, §62.15, page 1540 (14th ed. 1964):

> "Among other expenses incident to conducting a business and therefore allowable as administrative expendifure may be . . . payments of claims for personal injuries inflicted in the operation of a business. . . ."

E. *Tort Claims Have Always Been Given Priority as Costs and Expenses of Administration in Equity Receiverships.*

All of the equity receivership cases hold that claims for damages arising out of the torts of the receiver are costs of administration.

In *Sneedon v. Industrial Commission*, 366 Ill. 552, 10 N.E. 2d 327 (1937), it was held that compensation for injuries sustained by an employee of the receiver was an "expense of receivership."

In *Cowdrey v. Galveston, Houston and Henderson Ry. Co.*, 93 U.S. 352 (1876), the court said at page 354:

> "The allowance for goods lost in transportation, and for damages done to property whilst the road was in the hands of the receiver, was properly made. The earnings received were as much chargeable with such loss and damage as they were chargeable with the ordinary expenses of managing the road. The bondholders were only entitled to what remained after charges of this kind, as well as the expenses incurred in their behalf, were paid."

In *Farmers' Loan and Trust Co. v. Northern Pacific Railroad*, 74 Fed. 431 (C.C.D. Ore. 1896), the court recognized that equity requires payment of damages incurred during the operation of the receivership to be paid even prior to the first mortgage lien. In that case preference over the mortgage was denied for damages which occurred *prior* to the receivership. The court said at page 433:

> "Such claims for injuries occurring under the receiver's own management are paid, it is true, in preference to the mortgage debt, not for the reason of their preferential nature, nor because of any superior equity in their favor over claims for damages which arose before the receiver was appointed, but because they are liabilities which were incurred by the receiver in the course of his own operation of the road, and are payable by him as other expenses of the management."

In upholding an equity railroad receiver's contract for indemnity from injury to third parties (not employees), the court said in *Farmers' Loan and Trust Co. v. Carolina, C.G. & C. Ry. Co.*, 93 Fed. 543 (4 Cir. 1899) at p. 562:

> "It will not be disputed that a court of equity, which puts property in the charge of its receiver . . . will provide for the payment of all the *necessary* expenses incurred in the proper administration of the estate, before it orders distribution among creditors; and, if the receiver had operated this road himself, there can be little doubt that the court would have ordered the payment of all of these claims in priority to any claims of the bondholders. . . . That he may incur ordinary operating expenses is not disputed. This embraces all salaries of employees, ordinary supplies of material, and all expenses for keeping road and rolling stock in order; and the courts have held that *claims for damage to either person or property are included in the general class of operating expenses.*" (Emphasis added.)

See also *Union Trust Co. v. Illinois Midland Railway Co.*, 117 U.S. 434, 464-65 (1886).

In the case of *Anderson v. Condict*, 93 Fed. 349 (7 Cir. 1899), which involved the Englewood & Chicago Electric Street Railway Co., the same contention was made

as is urged by the respondents. The court said at pages 353-54:

> "But it is said that claims for personal injuries happening during the operation of the road by a receiver cannot be allowed, as a cost of administration, in priority to the receiver's certificates; . . . Technically, perhaps, payment for personal injury cannot correctly be denominated cost of operation; *but it is an expense incurred in and by reason of the operation*, and as such should be allowed in the accounts of the receiver. Klein v. Jewett, 27 N.J. Eq. 474. That such was the meaning of these decrees seems to us incontestable." (Emphasis added).

In *Bereth v. Sparks*, 51 F. 2d 441 (7 Cir. 1931), Sparks obtained a judgment against the receiver of a national bank on the theory that the receiver was a joint tort-feasor with the bank, and brought a bill in equity to have the judgment declared an administration expense entitled to priority over general creditors. The lower court held that the judgment was entitled to priority and the Court of Appeals of the 7th Circuit affirmed. The court stated, at page 442:

> "In the instant case, however, substantial evidence was introduced to the effect that the receiver was a joint tort-feasor ab initio, and in such event the following principles of law are applicable:
>
> " 'Damages, for injuries to persons or property during the Receivership, caused by the torts of the receiver's agent and employees, are classed as a part of the operating expenses of the corporation. Such expenses are to be paid and are payable out of the income of the property, if it is sufficient; or, if necessary out of the corpus. (Citing cases) . . . We think that Court properly held that appellant's claim constitutes an administration expense and is entitled to priority over general creditors.' "

A large collection of cases to the same effect is listed in the annotation to 28 U.S.C.A. §959, Note 626. Suffice it to say that petitioner has been unable to find a single case in which personal injuries or property damages caused by the receiver, or his agent, after the commencement of the receivership, were denied priority.

The court below stated (370 F. 2d, p. 627, Record App., p. 55) that it found no compelling persuasion in the foregoing cases, because the expression "costs and expenses of administration" in Section 64(a)(1) is a "purposeful statutory restriction" and the Federal courts cannot extend its reach or sweep "beyond its clearly defined provisions."[11] In the first place, petitioner disagrees that Section 64(a)(1) is a "purposeful statutory restriction" since it speaks broadly of "the costs and expenses of administration, including the actual and necessary costs and expenses of preserving the estate subsequent to filing the petition." There is no restriction in this language as to the items of costs or expenses of administration. Moreover, the portion of Section 64(a)(1) with which we are here dealing is far from being "well defined." There are no definitions. That is why the parties are required to resort to other sources, including equity receivership proceedings, to ascertain its proper construction.

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[11] In support of its findings that the words "costs and expenses of administration" are a "purposeful statutory restriction," the Court below relies heavily on *In re Connecticut Motor Lines, Inc.*, 336 F. 2d 96 (3 Cir. 1964), where it was stated that the 1962 amendment to Section 64(a)(1) was intended to restrict "costs and expenses of administration." Senate Report No. 1954, accompanying the amending legislation, H.R. 5393, August 28, 1962, U.S. Code Congressional and Administrative News, p. 2603 (1962), does not support this statement. The Senate Report clearly shows that the purpose of the amendment was to make more specific the scope of superpriority of claims for costs and expenses of administration in a superseding, liquidating bankruptcy proceeding over cost and expenses of administration in the debtor-relief proceeding. No such problem is involved here.

The language of Section 64(a)(1) standing alone has a clear meaning in the business world. If a party undertakes to operate a business, he must expect to incur expenses, not only for wages, materials, supplies and taxes, but also for any tort liabilities resulting from his operations. There is nothing in the language of the Bankruptcy Act which states that a receiver operating a debtor's property is exempt from any of these recognized costs of operating a business. Nor is there any need for the courts to "amend by judicial legislation," or to "extend the reach or sweep of," the language employed by Congress in Section 64(a)(1), as the court below indicated would be required before tort claims could be entitled to a priority status as costs and expenses of administration.

By every test—ordinary meaning of the words, accepted business practice, equitable principles, court decisions and writings of all recognized authorities on bankruptcy—the tort claims here involved clearly are entitled to priority as costs and expenses of administration of the debtor's estate.

F. *Damages Resulting from the Receiver's Negligence Are Just as Much an "Expense" of Conducting a Debtor's Business as Are Taxes, Wages, Materials and Supplies.*

The court below suggested (370 F. 2d, p. 628, Record App., p. 56) that decisions under the Internal Revenue Code holding that expenses to be deductible must be related to the preservation of the property or business supported its decision. What the court overlooked is that tort claims are "necessary expenses" of conducting business and deductible as such. See *Anderson v. Commissioners of Internal Revenue*, 81 F. 2d 457 (10 Cir. 1936); *Plante v. United States*, 226 F. Supp. 314 (D. N. H. 1963); Annotation, 20 A.L.R. 2d 600, Income Tax: Deductibility of amount paid or expense incurred by taxpayer on account of his liability or alleged liability for tort, crime or statutory violation.

The Department of Justice states at pp. 3-4 of its Memorandum in Opposition that "When, as in a Chapter XI proceeding, a trustee continues to operate the debtor's business, the courts have allowed such a first priority to amounts owed suppliers, employees, and others who deal with the estate after the filing of the petition." It rationalizes that, "By this priority, potential creditors are encouraged to deal with a business that would—without such priority—be a poor credit risk, . . ." The Department goes on to argue that "this rationale does not require giving the first priority of administrative expenses to a claim, such as petitioner's, which sounds wholly in tort."

Certainly such an argument, if valid, would be equally applicable to tax claims accruing during the administration of debtor's estate and require their exclusion. Yet, such tax claims are accorded a first priority as an expense of administration. 3 Collier on Bankruptcy, §62.14, p. 1529 (14th ed. 1964). See also, dissenting opinion of the court below, 370 F. 2d 628-29, Record App., pp. 57-8.

II. The Effect of the Judgment of the Lower Court Is Violative of Due Process.

It is obvious from the foregoing that this Court need not reach a Constitutional question in order to reverse the court below. However, we submit that the effect of the refusal of the lower court to allow the claim of petitioner is a violation of the due process clause of the Fifth Amendment.

Unless the damage claims arising out of the fire are allowed as expenses of administration they have no standing at all. The general claims outlined in Section 63 of the Bankruptcy Act are debts incurred by the bankrupt prior to the filing of the petition. Obviously these fire claims are not obligations of the debtor since the operation of the business had been taken out of its hands at the time of the fire. There is no specific provision in Section 64, the priority section, relating to claims arising out of the receiver's torts,

nor is there any general provision which could include them other than "costs and expenses of administration." It therefore follows that unless the claims are expenses of administration, neither the bankrupt estate nor the receiver personally has any responsibility whatever to the persons damaged by the fire.[12]

In the absence of some reasonable basis for the denial of these rights and the immunization of the bankrupt estate from tort claims, this is a violation of due process. See *Louisville Bank v. Radford*, 295 U.S. 555 (1935); *Wright v. Union Central Life Insurance Co.*, 304 U.S. 502 (1938); 1 *Remington on Bankruptcy* (Henderson ed. 1950).[13] As we have pointed out above, there is no reasonable basis for granting such immunity.[14]

The Department of Justice asserts (Memorandum in Opposition, p. 7) that petitioner has suffered no injury because it still has the right to sue the trustee. The answer is that such a suit is utterly meaningless. While the suit is nominally against the trustee, it is actually against the

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[12] The receiver is not personally liable nor does he have any responsibility after his discharge. This Court so held in *McNulta v. Lochridge*, 141 U.S. 327 (1891), where it stated at page 332:

> "Actions against the receiver are in law actions against the receivership, or the funds in the hands of the receiver, and his contracts, misfeasances, negligences and liabilities are official and not personal, and judgments against him as receiver are payable only from the funds in his hands."

[13] 1 Remington on Bankruptcy §11, p. 23 (Henderson ed. 1950) states as follows:

> "Within the proper range, Congress is not required to leave creditors the right to the full and untrammeled result of use of the usual common-law remedies to enforce their obligations. It must, however, respect property rights and other fundamental rights under the constitution and general restrictions upon its powers except to the extent reasonably necessary to deal adequately with bankruptcies and insolvency situations."

[14] Moreover, to do so would run counter to the general recognition today that tort immunity has little justification. See, e.g. *United States v. Muniz*, 374 U.S. 150, 165-66 (1963).

bankrupt estate since the trustee has no personal responsibility. *McNulta v. Lochridge*, 141 U.S. 327 (1891). A judgment is not automatically provable in bankruptcy; it depends upon the nature of the claim which gave rise to the suit. *Dickinson v. Universal Service Stations*, 100 F. 2d 753 (9 Cir. 1938). Under the holding below a tort claim against the estate even though reduced to judgment is not provable and therefore unenforceable and completely worthless.[15]

Conclusion

In conclusion we submit that the damages caused by the receiver's negligence must be paid out of the estate as expenses of administration. This result is in accord with business practice, all of the court decisions, the writings of all recognized authorities and the equitable principles which govern the administration of the Bankruptcy Act. A contrary holding would nullify the Act of Congress requiring receivers to operate the debtor's business in accordance with State law and would deprive the victims of the receiver's negligence of their property without due process of law. The judgment of the court below should be reversed.

Respectfully submitted,

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November 29, 1967

[15] The government says that petitioner is "in no different circumstances than any claimant against a judgment-proof tort feasor" (Memorandum in Opposition, p. 7). What this argument ignores is that the tort feasor is judgment proof only because this decision makes him so. The government's analogy to torts committed prior to the bankruptcy proceedings ignores the whole point in this case. It is because the tort was committed by the receiver while operating the business for the benefit of general creditors that these claims are entitled to preferred status.

CERTIFICATE OF SERVICE

STATE OF PENNSYLVANIA:
COUNTY OF PHILADELPHIA: ss.

I, THOMAS RAEBURN WHITE, JR., counsel for the petitioner herein, and attorney of record for petitioner in the courts below, state that on the 29th day of November 1967, I served five copies of the foregoing Petitioner's Brief on the respondents, as required by Rule 33, by personally mailing said copies hereof to Messrs. Dechert, Price and Rhoads, in care of their office, 1600 Three Penn Center Plaza, Philadelphia, Pennsylvania 19102, and on the United States by mailing five copies to the Solicitor General, Department of Justice, Washington 25, D. C., and to Richard M. Roberts, Assistant Attorney General, Department of Justice, Washington, D. C. 20530, the attorney who argued the case for the United States in the courts below.

THOMAS RAEBURN WHITE, JR.
Member of the Bar of the
United States Supreme Court

Appendix to Brief

Amendment V — Capital Crimes; Double Jeopardy; Self-Incrimination; Due Process; Just Compensation for Property

No person shall be held to answer for a capital, or otherwise infamous crime, unless on a presentment or indictment of a Grand Jury, except in cases arising in the land or naval forces, or in the Militia, when in actual service in time of War or public danger; nor shall any person be subject for the same offence to be twice put in jeopardy of life or limb; nor shall be compelled in any criminal case to be a witness against himself, nor be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation.

11 U.S.C. §11 (Bankruptcy Act §2)

§11. *Creation of courts of bankruptcy and their jurisdiction.*

(a) The courts of the United States hereinbefore defined as courts of bankruptcy are hereby created courts of bankruptcy and are hereby invested, within their respective territorial limits as now established or as they may be hereafter changed, with such jurisdiction at law and in equity as will enable them to exercise original jurisdiction in proceedings under this title, in vacation, in chambers, and during their respective terms, as they are now or may be hereafter held, to—

* * * * *

(2) Allow claims, disallow claims, reconsider allowed or disallowed claims, and allow or disallow them against bankrupt estates;

11 U.S.C. §102(a)(1) (Bankruptcy Act §62(a)(1))

§102. *Expenses of administering estates; unauthorized sharing of fees; withholding allowances.*

(a) (1) The actual and necessary costs and expenses incurred by officers, other than referees, in the administration of estates shall, except where other provisions are made for their payment, be reported in detail under oath, and examined and approved or disapproved by the court. If approved, they shall be paid or allowed out of the estates in which they were incurred.

* * * * *

11 U.S.C. §103(a)(7) (Bankruptcy Act §63(a)(7))

§103. *Debts which may be proved.*

(a) Debts of the bankrupt may be proved and allowed against his estate which are founded upon . . . (7) the right to recover damages in any action for negligence instituted prior to and pending at the time of the filing of the petition in bankruptcy; . . .

* * * * *

11 U.S.C. §104(a)(1) (Bankruptcy Act §64(a)(1))

§64. *Debts Which Have Priority.*

(a.) The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estate, and the order of payment, shall be (1) the costs and expenses of administration, including the actual and necessary costs and expenses of preserving the estate subsequent to filing the petition; the fees for the referees' salary and expense fund; the filing fees paid by

creditors in involuntary cases or by persons other than the bankrupts in voluntary cases; where property of the bankrupt, transferred or concealed by him either before or after the filing of the petition, is recovered for the benefit of the estate of the bankrupt by the efforts and at the cost and expense of one or more creditors, the reasonable costs and expenses of the recovery; the trustee's expenses in opposing the bankrupt's discharge or in connection with the criminal prosecution of an offense punishable under chapter 9 of Title 18, or an offense concerning the business or property of the bankrupt punishable under other laws, Federal or State; the fees and mileage payable to witnesses as now or hereafter provided by the laws of the United States, and one reasonable attorney's fee, for the professional services actually rendered, irrespective of the number of attorneys employed, to the bankrupt in voluntary and involuntary cases, and to the petitioning creditors in involuntary cases, and if the court adjudges the debtor bankrupt over the debtor's objection or pursuant to a voluntary petition filed by the debtor during the pendency of an involuntary proceeding, for the reasonable costs and expenses incurred, or the reasonable disbursements made, by them, including but not limited to compensation of accountants and appraisers employed by them, in such amount as the court may allow. Where an order is entered in a proceeding under any chapter of this title directing that bankruptcy be proceeded with, the costs and expenses of administration incurred in the ensuing bankruptcy proceeding shall have priority in advance of payment of the unpaid costs and expenses of administration, including the allowances provided for in such chapter, incurred in the superseded proceeding and in the suspended bankruptcy proceeding, if any; (2) wages and commissions, not to exceed $600 to each claimant, which have been earned within three months before the date of the commencement of the proceeding, due to workmen, servants, clerks or travel-

ing or city salesmen on salary or commission basis, whole or part time, whether or not selling exclusively for the bankrupt; and for the purposes of this clause, the term "traveling or city salesman" shall include all such salesmen, whether or not they are independent contractors selling the products or services of the bankrupt on a commission basis, with or without a drawing account or formal contract; (3) where the confirmation of an arrangement or wage-earner plan or the bankrupt's discharge has been refused, revoked, or set aside upon the objection and through the efforts and at the cost and expense of one or more creditors, or, where through the efforts and at the cost and expense of one or more creditors, evidence shall have been adduced resulting in the conviction of any person of an offense under Chapter 9 of Title 18, the reasonable costs and expenses of such creditors in obtaining such refusal, revocation, or setting aside, or in adducing such evidence; (4) taxes which became legally due and owing by the bankrupt to the United States or to any State or any subdivision thereof which are not released by a discharge in bankruptcy: *Provided, however,* That no priority over general unsecured claims shall pertain to taxes not included in the foregoing priority: *And provided further,* That no order shall be made for the payment of a tax assessed against any property of the bankrupt in excess of the value of the interest of the bankrupt estate therein as determined by the court; (5) debts other than for taxes owing to any person, including the United States, who by the laws of the United States is entitled to priority, and rent owing to a landlord who is entitled to priority by applicable State law or who is entitled to priority by paragraph (2) of subdivision (c) of Section 107 of this title: *Provided, however,* That such priority for rent to a landlord shall be restricted to the rent which is legally due and owing for the actual use and occupancy of the premises affected, and which accrued within three months before the date of bankruptcy.

28 U.S.C. §959(a) and (b)

§959. *Trustees and receivers suable; management; State laws.*

(a) Trustees, receivers or managers of any property, including debtors in possession, may be sued, without leave of the court appointing them, with respect to any of their acts or transactions in carrying on business connected with such property. Such actions shall be subject to the general equity power of such court so far as the same may be necessary to the ends of justice, but this shall not deprive a litigant of his right to trial by jury.

(b) A trustee, receiver, or manager appointed in any cause pending in any court of the United States, including a debtor in possession, shall manage and operate the property in his possession as such trustee, receiver or manager according to the requirements of the valid laws of the State in which such property is situated, in the same manner that the owner or possessor thereof would be bound to do if in possession thereof. June 25, 1948, c. 646 62 Stat. 926.